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Mrs Carolyn Rogers
Secretary General
Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel
Switzerland

January 6, 2021

Re: Big Tech and Banking

Dear Mrs Rogers,

We would like to thank you once again for the opportunity we had to present the outcome of our report on Big Tech and Banking.

In the discussion you pointed out that the Basel Committee is well aware of the growing impact of BigTech, but is bound to operate within its regulatory perimeter and scope of authority. You added that so far, BigTechs don't seem to doing maturity transformation, are being funded by private money as opposed to depositor funds, and lack leverage. While different in emerging markets, it did not appear that BigTechs had actually replaced banks for the full value chain.

At the end of the meeting we promised to send a letter explaining more concretely how the unbundling of financial services and the activities of BigTechs can potentially create prudential or systemic risks that need to be addressed in order to ensure the safety of the system. We believe that this neatly fits with the work the Basel Committee is doing monitoring the developments in the banking sector and financial markets, identifying current or emerging risks for the global financial system and addressing potential regulatory and supervisory gaps.

We have worked out 2 examples that you will find attached. The cases illustrate the potential risks to financial stability that were also identified by the FSB as BigTechs are entering financial services, benefitting from clear advantages in terms of scale, innovation capacity and data, significant financial resources and access to capital and funding at much lower cost than traditional banks. According to the FSB the risks stem from leverage, maturity transformation and liquidity mismatches, as well as operational risks including those that might arise from potential shortcomings in governance, risk and process controls.

In our report we found that BigTechs' entry in financial services is largely in the retail and small- and medium sized enterprise segments, while more limited in corporate and investment banking. Many of the BigTechs' services are overlays on existing bank infrastructures that can, over time, substitute for traditional financial products and services. BigTechs frequently offer products and delivery mechanisms that resemble regular financial activities but are not yet fully classified as such within the existing regulatory framework. For example, peer-to-peer lending portrayed as "intermediating payment transactions" instead of "bank loans". Or e-wallet money balances or cryptocurrencies not considered as deposit taking. Or, they offer services for which existing regulation is entity-based, making it unclear which requirements should apply if the activity is performed by different types of entities.

Our report evidences that a significant part of big tech activities draw on data and dominant positions outside the financial sector, which are governed by cross-sectoral regulations (such as data or competition). These may still be under development or are still being enhanced by authorities to adapt to new market circumstances. Financial regulators have some established powers, rules, and supervisory practices on many of these areas, such as data, corporate governance, conduct, consumer protection, and anti-money-laundering and counterterrorism financing. But they cannot be legally enforced outside a specific financial license.

We discussed the need for complementing an entity-based approach with an activity-based approach.

The examples attached demonstrate the potential regulatory arbitrage and diffusion of accountability as value chains unbundle across multiple players. We see BigTechs selling products on one of their platforms, linked to a credit offer processed by a second platform, with credit scoring generated from data gathered on all platforms, and at the end of the chain, a third-party bank signing-off the underwriting and providing the funds.

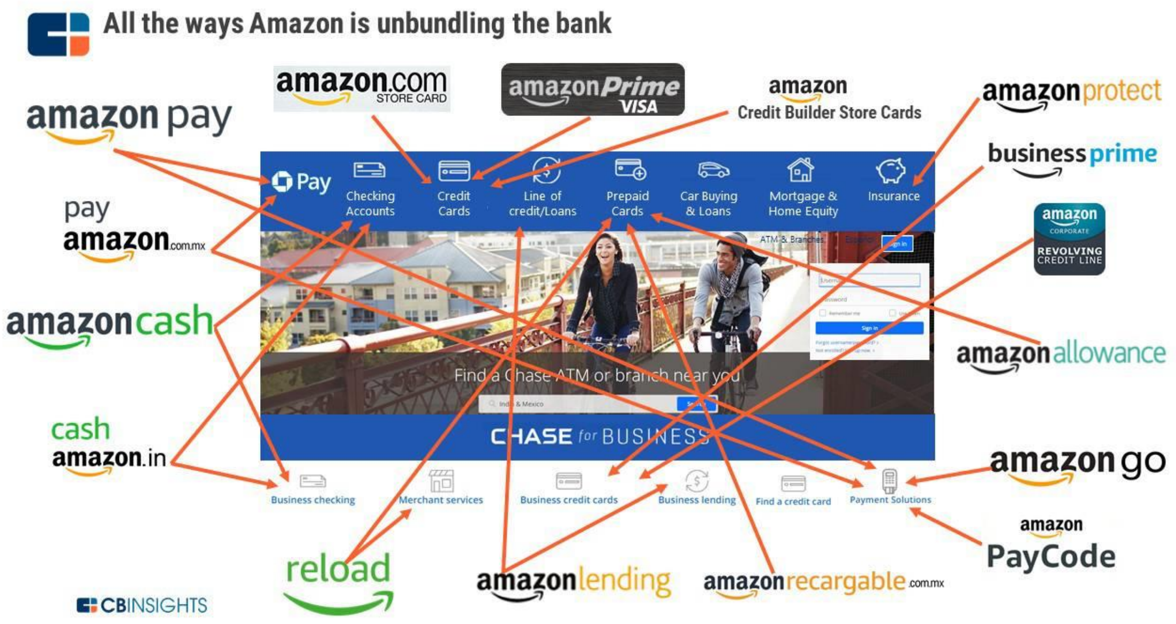
We are very much willing to further exchange with you on the subject.

Yours sincerely,

Hedwige Nuyens
Managing Director IBFed

<u>Case Study: Amazon</u>

Context:
Central to the core strategy of any digital platform is increased participation by customers in its ecosystem. To achieve this Amazon is unbundling financial products of traditional firms and reorientating and reoffering them to enable consumers and new value chains in its ecosystem. Using available information this case study will demonstrate how in aggregate Amazon's delivery of shadow financial services is a development in financial services and warrants analysis for what it may mean for overall emerging risks in the global financial system. It will focus on four areas of Amazon's offering: lending, Amazon cash, insurance and payments and note the impact beyond of Amazon's online presence and in the real economy. This unbundling and reorientation is illustrated below:



Amazon Lending
A priority for Amazon is increasing the number of consumers and merchants on its platform. Amazon therefore supports both groups through lending and credit. While this may partly be done with existing established financial services firms it is clear Amazon has become a critical part in the chain of credit provision. If Amazon were to fail it would have an impact beyond just an online retailer.

Amazon has scaled to such an extent that a significant number (some estimate c. 25%) of small and medium size enterprises depend on it for survival. If Amazon were to fail, these SMEs have no alternative distribution model and would also fail. These SMEs also have credit risk to Amazon, because of its 21-day settlement period. It is estimated Amazon is sitting on total direct and indirect economic risks to UK economy of c.£10bn.

SMB lending
- Amazon Lending has partnered with Bank of America Merrill Lynch, Goldman Sachs and ING to issue loans in the US and Germany between $1,000 to $1M.

- From launch in 2011 to Q1 2019, Amazon reported it issued $5B across more than 20,000 business in the US, Japan, and the UK.[1]

Consumer lending

Amazon offers several partner cards for Prime and non-Prime customers, often with benefits which can be realised inside the Amazon ecosystem which include:

- Amazon Store Card[2]
- Amazon Prime Store Card[3]
- Amazon Platinum Mastercard[4]
- Amazon Classic Mastercard[5]

Payments

Amazon has invested heavily in removing friction from the buying and selling process and invested in payments infrastructure and services to do so. Since 2019 it has invested in its own marketplace, and has formed a partnership with acquiring bank Worldpay (subsequently acquired by FIS, one of the biggest providers of core banking processing) [6].

Amazon Pay has evolved to include a digital wallet for customers and a payments network that consumers can use in online and in physical locations. This means Amazon has become an integrated part of the purchase process across the digital economy and in shops.

Amazon Cash

Amazon Cash allows customers to deposit cash, without a fee, to a digital account. Amazon formed a partnership with Coinstar which means when consumer cash out they can choose to cash our directly to their Amazon Cash depository. If Amazon failed it would have an impact beyond an online retailer and on whatever cash was tied to an account and gift card.

Insurance

Amazon has developed a number of insurance products to further enable consumers on its platform, and 'offers additional coverage against accidental or manufacturer's induced damage or theft for select electronic products.'[7]

Conclusion

Amazon has unbundled the services offered by many banks and is now offering financial services to enable (and encourage) customers to participate in its own ecosystem. This can be observed in four areas: lending, Amazon cash, insurance and payments. In aggregate, this activity provides much of the shadow architecture and service provision of a financial firm, and is therefore a development in financial services, even if it is orientated towards enabling consumers to participate in the Amazon ecosystem. This impact is not limited to its online presence but through its partners (such as Whole Foods) and its systemic role for SMEs is amplified in the real economy.

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[1] CB Insights: Amazon In Financial Services
[2] https://www.amazon.com/gp/cobrandcard/marketing.html?pr=conplcc
[3] https://www.amazon.com/gp/cobrandcard/marketing.html?pr=conplcc
[4] https://www.amazon.co.uk/compare-credit-card-offers/b?ie=UTF8&node=367529031
[5] https://www.amazon.co.uk/compare-credit-card-offers/b?ie=UTF8&node=367529031
[6] CB Insights: Amazon In Financial Services
[7] https://www.amazon.co.uk/gp/help/customer/display.html?nodeId=202011490

Case Study: Ant Group

Context:[8]
Ant Group is the parent company of Alipay, created in 2004 to solve the trust issue between buyers and sellers in online transactions, underpinning the development of e-commerce in China. Through the ubiquitous (anytime, anywhere) super app Alipay:

- Consumers can access financial services (payments, consumer credit, investment and insurance), as well as daily life services (food delivery, transportation, entertainment, and municipal resources for citizens).
- Businesses can receive payments, access SMB credit and investment products, and offer daily life services through the Alipay app and over two million mini programs, easily discoverable by consumers through the Alipay search function or customized icon placement.
- Financial institutions can access Ant's platform to distribute credit, investment and insurance products, powered by Ant's intelligent decisioning [9] and dynamic risk management solutions10, AI, algorithms, Analytics as well as technology infrastructure. As a provider of technology, Ant collaborates with, rather than competes against, its partner financial institutions.

With China's economy shifting towards domestic consumption and the growth of small businesses, the financial services needs of consumers and small businesses have expanded considerably and demand for credit, investment and insurance products is projected to increase substantially. According to Ant Group, these needs are underserved by brick and mortar channels of the financial system because of the lack of reach and customer insights in the process of underwriting risk, for example in the case of a micro-loan or small-claims insurance. A large number of Ant's consumers and small businesses have no or only a limited credit history, fewer financial resources or a lower borrowing capacity than large entities. Ant is collaborating very closely with Alibaba, jointly serving consumers and merchants across consumption and daily life use cases, sharing insights derived from platform activity, and expanding cross-border activities.

Payments – 35% of total revenues

- Ant Group is the leading digital payments provider and platform in China with RMB 118 trillion volume on a yearly basis, reaching 1 billion users and 80 million merchants. Ant Group has established international payment connections to meet the needs of an increasingly digitalized global economy.

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[8] The case study is mainly based on the document released ahead of the IPO launched by the Ant Group in 2020 https://www1.hkexnews.hk/app/sehk/2020/102484/documents/sehk20082500535.pdf

[9] Ant uses a constant stream of customer insights and our proprietary algorithms to analyze and dynamically update the assessment of a customer's creditworthiness, the likelihood of a customer accepting a credit product and the best ways of marketing products.

[10] Based on customer insights and risk rating in terms of spending, assets, liabilities, occupation, and other parameters such as financial stability, Ant categorizes all Alipay users into different risk categories. For each category, we design customized models as well as tailored strategies for credit line approval and pricing. Ant has currently more than 100 credit assessment models, achieving quantitative credit decisioning processes which are intelligent, automated and dynamic, covering the lifecycle of each loan before, during and after its origination.

- Ant Group generates digital payment services revenues by charging merchants transaction fees based on a percentage of volume.

Lending – CreditTech – 40% of total revenues

- Ant Group is the largest online consumer credit and SMB credit services provider in China, with RMB 1.7 trillion (+-$259bn) CreditTech Consumer credit and RMB 0.4 trillion SMB Credit Balance. Huabei offers consumers an interest-free period of up to 40 days after they make purchases. Jiebei is a short-term digital unsecured consumer credit product for users who either have already developed a credit history on our platform or those who are eligible for Huabei, identified by Ant's intelligent decisioning systems for arpproving a credit line. The loans originated through its platform, are underwritten by partner financial institutions (>100 as of now). Approximately 98% of the credit balance originated through its platform are underwritten by partner financial institutions or securitized. Ant Group's approach is not to use its own balance sheet or provide guarantees.
- Ant Group generates technology service fees from its partner financial institutions, based on the credit balance originated through its platform.

Asset Management – InvestmentTech – 15% of total revenues

- Ant Group is the largest online investment services platform in China, with RMB 4.1 trillion assets under management. Through the platform the client has access to transparent, personalized and easy-to understand investment options with low minimum investment amounts. Yu'ebao for example, is an innovative product that offers a simple and easy way for consumers to earn a return while allowing the funds to be instantly available for everyday purchases. Yu'ebao is the largest money market fund product in China.
- Ant Group uses AI to provide intelligent matching of investment products with customers taking into account their risk tolerance. The massive user base, technology, customer insights and the trust consumers place in Alipay's brand helps the >170 partner financial institutions to expand the reach of a broad range of innovative investment products to a wider customer segment.
- Ant Group generates technology service fees from its partner financial institutions, based on the volume of investment products distributed through its platform.

Insurance – InsureTech – 8% of total revenues

Ant Group is the largest online insurance services platform in China, with RMB 52 billion premiums and contributions on a yearly basis generated through its platform. Clients have access to a wide range of innovative, customized and accessible insurance products, covering life, health and P&C insurance areas, offered by >90 partner insurance institutions in China. The ongoing digitalization of the economy presents transformative opportunities in the insurance sector, as any risk-bearing activity may be insured against where there is sufficient high-quality data. The massive scale and commercial nature of its platform and the Alibaba ecosystem enables to innovate and to develop new insurance products that address consumer and business needs.

Ant Groups receives technology service fees from its partner insurance institutions based on a percentage of the insurance premiums and contributions generated through its platform.

Regulatory and Supervisory Framework

In July 2019, the PBOC issued a draft regulation on financial holding companies for comments.

In the IPO Prospectus Ant Group disclosed its plans to use Zhejiang Finance Credit Network Technology Co., Ltd., a wholly owned subsidiary, as the entity to apply for being a financial holding company subject to regulation and hold licensed financial services subsidiaries. Ant owns a 30% equity interest in MYbank, its most important partner for SMB CreditTech services and InvestmentTech services for which MYbank possesses the necessary licenses and permits.

On November 2, 2020 the PBOC and CBIRC jointly issued draft rules, requiring online micro loan businesses to provide at least 30% of any loan fund jointly with banks.[11] There would also be a RMB 5 bn registered capital threshold for micro-lenders that offer loans online across different regions (the current threshold varies between provinces but is <RMB 1 bn). Micro-lenders which source borrower data from ecommerce platforms to assess their credit would be required to share the credit information with the central bank. Reuters quotes Guo Wuping, head of the consumer protection division at CBIRC, “the rights of users of Ant-owned consumer loan companies Huabei and Jiebei deserve close scrutiny. Fintech loan companies effectively perform the functions of banks and should adopt similar risk controls.” Last but not least, there would be a limit for online micro-loan balance for natural persons in China to the lower of either RMB 300K (approx. USD 45K) or one third of the average annual income of such persons for the past three years. The online micro-loan balance for legal persons or other institutions would be limited to RMB 1 million.[12]

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[11] https://www.reuters.com/article/china-lending/update-1-china-issues-draft-rules-to-regulate-online-micro-lending-business-idUKL1N2HP035
http://www.cbirc.gov.cn/en/view/pages/ItemDetail.html?docId=943996&itemId=980

[12] https://www.chinabankingnews.com/2020/11/03/china-unveils-new-online-lending-regulations-restricting-cross-border-operation-leverage-levels-and-lending-amounts/